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Solving the Philippine Puzzle

Towards a social market economy framework
for Philippine Development

A Policy Statement



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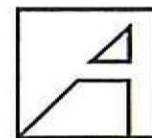
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Introduction

The Philippine puzzle

Why has the Philippines been under-performing economically vis-à-vis its East Asian neighbors for two decades now and vis-à-vis South Asian countries like India since the 1990s? The fact that the Philippines was less adversely affected by the East Asian financial crisis of the late 1990s should have allowed it to move much faster than its neighboring countries after the crisis. However, the country's investment and economic performance since the crisis has been less than sterling compared to the performance of countries like South Korea, Thailand, and Malaysia.

The perennially under-performing Philippine economy is a puzzle because many observers consider the country relatively rich in human capital (i.e., talented and educated people) and moderately rich in natural resources, two important ingredients for economic success. In short, the Philippine puzzle is: **How did a country with comparatively educated and creative people, and with good natural resources, end up being a growth laggard, poor, and with high unemployment?**

Lessons from successful economies

A close look at some of the more important economic success stories during the past few decades reveals an important underpinning of such economic successes; that is, **institutions, society, and economic strategy fit together**. There is a general overall consensus on, and political will to follow, a broad strategy of development that is consistent with the characteristics of each country's society. The broad strategy includes institutional arrangements in the sharing of costs and rewards of economic adjustment and progress.

For example, Germany's economic success in the post World War II era was underpinned by its social market economy framework embodying dynamic market competition (and openness) and by the principle of co-determination. Under co-determination,

government had a hands-off policy in industrial relations, but the labor sector has a significant role in the management of enterprises.

Similarly, Japan's long-term ("lifetime") employment, *keiretsu* and export-biased competition for the government's industrial support programs were key institutional arrangements and development strategies during Japan's rapid industrialization from the 1950s to the 1970s. The *keiretsu* allowed for flexibility in the management of commodity market shocks while the "lifetime employment" practice encouraged greater familial links of the workers with the firms.

The more recent economic success stories of Malaysia and Singapore combine economic openness with institutional arrangements to ensure a more equitable distribution of economic benefits. Both countries are among the most open among the developing countries. They have very low tariffs in most industries, and they welcome foreign investments. In addition, Malaysia set out a policy bias for Malay *bumiputeras*, especially in the 1970s and early 1980s, in government jobs, education and entrepreneurship subsidies in order to prevent a worsening of the economic and social divide between the poorer Malays and the hitherto richer Chinese Malaysians. Similarly, Singapore embarked on major housing and education programs for its citizens to widen the benefits of its growth that relied substantially on investments of multinationals.

No single recipe for success

The above-mentioned examples demonstrate that there is not one single recipe for economic success that can be copied and effectively transplanted to any part of the world. Each is a "development model" that is hewed to the characteristics of each society and which became the framework shaping policy and socio-economic relations. The uniqueness of each development model lies in the "country-specific" institutional arrangements of economic relations and sharing of the costs and rewards of economic adjustment and progress.

However, it must be pointed out that there are very important commonalities that run through the above-mentioned success stories. These include: (a) macroeconomic stability; (b) dynamic market competition at home; (c) strong export orientation; (d) openness to technology and, for the more recent economic success stories, foreign investment; and (e) relatively good governance and policy consistency for a long period of time. The end result has been robust and sustainable productivity and output growth thereby substantially reducing or altogether eliminating dire poverty.

A fundamental reason for the under-performance of the Philippine economy during the past few decades is that the country has yet to work out and implement for a significant period of time its own "development model", one that sets out the institutional arrangements consistent with Filipino values and Philippine circumstances and one that meets the challenges of international economic competition at the same time.

Philippine economic policy: a brief review

In a way, the country's institutions and socio-political system do not yet quite fit the imperatives of dynamic market competition, openness, and technological changes in the world.

Thus, for example, the country did not have an outward-oriented economy for much of the post World War II period, in contravention of the experiences of the success stories. The country pursued a strategy of economic protectionism and highly circumscribed foreign investment regime during the 1950s, 1960s, and 1970s, propped up by rising foreign debt. The economic benefits of this strategy proved transitory and highly variable, resulting in the stop-go nature of Philippine economic growth performance during the period.

As noted above, this strategy is inconsistent with the economic openness and export orientation of the successful economies. It must be pointed out that the protectionist policies of Japan and South Korea in the early years of their industrialization were counteracted by export performance-based fiscal and credit subsidies

and, for Japan, an apparent under-valuation of the Japanese yen. In effect, the net bias of industrial policy was export promoting. In contrast, the Philippine credit and fiscal subsidies in the 1950s and the 1960s were not strongly linked with export performance. As such, Philippine industrial policy at that time was strongly biased towards import substitution.

The decades of economic protectionism and insular thinking in the country after World War II have been largely replaced in recent years by a bias for economic openness and globalization, following the ideology of the so-called Washington Consensus. However, the results have not been altogether overwhelmingly successful. Policy inconsistency (i.e., peso real appreciation, industrial tariff reduction, rise in agricultural protection) in the face of the emergence in the international export market of low labor cost countries such as China and Vietnam contributed to the hollowing out of the country's manufacturing sector in the 1990s. Income inequality widened, and given rising population the number of poor people grew, thereby undermining the socio-political support for the economic strategy following the Washington Consensus.

In addition, and equally important, the country has largely muddled through in developing the institutional arrangements - and the institutions - that would help the country address effectively the challenges of market competition and globalization on the one hand, and the imperatives of social welfare and equity, on the other. The current political uncertainty and apparently growing despair over the ineptness of the country's political institutions are reflective of, and, at the same time, feeds into the country's social divide and lack of national consensus.

In short, the country has so far failed to create a consensus on the economic strategy and institutional arrangements that encapsulate Philippine society but which nonetheless effectively address the challenges of dynamic market competition, economic openness, globalization, and social equity. What we need is a *Philippine development model or a social market economy model*

for the Philippines, if you will, that becomes the rallying point for Filipino policy makers, government bureaucrats, businessmen, laborers, farmers, students, and other groups in society.

Four critical challenges

The Philippines faces four critical challenges as it strives to achieve robust economic and employment growth, and to substantially reduce poverty in the face of a comparatively high population growth rate. These challenges are the following: (1) low productivity growth; (2) fragile macroeconomy; (3) widening social inequality and frayed social fabric; and (4) weak institutions.

First, the Philippines has suffered from low productivity growth, resulting in declining international competitiveness. The growth of output per worker and the contribution of total factor productivity in the Philippines have been far less satisfactory since the 1970s compared to those of neighboring countries in Northeast and Southeast Asia. Agricultural crop yields lag substantially behind those of the best performing countries in the region.

This relatively poor productivity performance for a substantial period of time is translated into declining international competitiveness of the country. It also lead to pressures for increased protectionism and to a decreased confidence on the part of Philippine producers in their ability to compete well in the marketplace.

The Philippines needs sustained high rates of growth over a significant period of time in order to dramatically reduce, if not eliminate, poverty in the face of its comparative high rate of population growth. High rates of economic growth demand high rates of investment, from foreign investment and rising domestic saving. A high investment rate demands a stable macroeconomic environment that reduces financial risks and facilitates long term planning. The more efficiently allocated investment resources are, the higher the growth impact – hence, the importance of dynamic market competition and outward orientation. The first emphasizes intense and fair domestic market competition among firms – price or in non-price areas such as product innovation and service quality. Competition forces firms to be efficient. The second highlights benchmarking against foreign competitors and aiming for the world market. Thus, the competitive pressure includes competition from

foreign suppliers in the domestic market and foreign competitors in the export market. In short, high investment rates financed less from loans but from foreign direct investment and domestic saving and intense and fair competition, which together lead to robust productivity growth, are the foundations of a sustained high economic growth rate and a rapidly declining incidence of poverty.

The emergence of low labor cost countries such as China and Vietnam as investment magnets and export bases since the late 1980s means that the Philippines needs to rely on high labor productivity, timeliness of supply, and product innovation instead of comparatively low wages to maintain international competitiveness. This implies much improved infrastructure and logistic services, which is a particularly daunting task for the Philippine because the country has the worst infrastructure stock among the major economies in the East Asian region. Robust labor productivity growth also calls for greater focus on technological upgrading of firms, increased reliance on training and human capital, both firm-specific training of workers and broader as well as better basic education services especially for the poor. Note that all the major interventions mentioned above call for increased investment from both the government and the private sector. It is thus critical to improve the investment climate in the country in order to raise the country's investment rate.

Second, the country's macroeconomy remains fragile, characterized by a growing fiscal deficit and public debt, and by the high ratio of non-performing loans (NPLs) of the country's banking sector. The deterioration in the country's fiscal situation during the past few years has led to a rise of the risk factor in the pricing of the country's debt papers. It has also contributed to the increase in the threshold rate of return requirements for investments, which is a factor in the slowdown in foreign investment inflow during the period. The rise of non-performing loans, on the other hand, has made the banking sector more cautious in its lending activities, therefore impairing the availability of credit for long-term investments.

Third, in recent years, social inequality in the country has worsened and the number of poor people has increased. In fact, the country belongs to the group of countries in the world with highly unequal distribution of income. This is aggravated by the high population growth rate of the country, which stretches the ability of government to provide the basic social services (e.g., health, nutrition, education) to the poorest segments, which also happen to have bigger family sizes. We are, therefore, faced with an "intergenerational effect", a situation in which the poor families have poorer prospects because of their inability to extricate themselves from their situation arising from lack of access to health and education services.

Combined with the high incidence of absolute poverty, this situation of increasing inequality of income distribution is particularly worrying for the country since it could lead to social and political upheavals. Preventing the social volcano to erupt by addressing the serious problems of absolute and relative deprivation is a major challenge that faces the country's leaders and institutions.

Unfortunately, the two critical government institutions that are central to addressing these problems — bureaucracy and political parties — are particularly weak and have serious problems of their own.

Appointments in the bureaucracy, for example, have been substantially influenced by political patronage, largely due to the fact that presidential appointments are made down to the director level, in contrast to other countries where political appointments largely stop at the ministerial level. Moreover, salaries from middle management and up are very low compared to the private sector, leading to the early exit of the more promising in the government bureaucracy. As a consequence, there is less continuity and greater unpredictability in the implementation of policies in the Philippines, which contributes to the comparatively low level of foreign investments in the country.

The other important political institution that can harness national consensus and resources to effectively address the twin

problems of absolute deprivation and relative deprivation are the political parties, and by extension, the political process itself. However, Philippine political parties are particularistic and personality-dependent rather than programmatic. In addition, the political process is prone to corruption and regulatory capture. With the increasing cost of elections, the political process becomes hostage to the contests among the economic-political elite. Furthermore, government decision-making and policy-making is substantially shaped by deal making, thereby resulting, at times, in policy inconsistency, policy distortions, and / or rent seeking.

The country has a poor image with respect to governance. The country ranks high up in the region in terms of perception of corruption. Some people are saying that the degree of corruption has deteriorated over the years, which is reflected in the secular deterioration of the country's corruption perception index. Policy and political uncertainty has bedeviled the country in recent years. It is also acknowledged that getting a business started in the country generally takes much longer than in a number of countries in the region. Peace and order is a constant worry and the integrity of the country's courts is highly suspect. It is increasingly acknowledged that reducing corruption and addressing governance problems is critical for making the country a favored site for foreign direct investment. It could be argued that other countries in the region like China have serious problems of corruption also. However, in contrast to China, Philippine labor and infrastructure costs are already comparatively high. Hence, there is little leeway for factoring in the cost of corruption without hurting the competitiveness of Philippine exports and import substitutes. That is, the Philippines cannot afford to be very corrupt and still remain a favored site for foreign direct investment.

In summary, policy distortions, weak institutions, and corruption lead to low investment, sluggish economic growth, and slow employment expansion. The end result is high incidence of unemployment and poverty. In short, what the country needs to dramatically reduce poverty is high and equitable economic growth

for a substantial period of time. However, in the face of increased competition for markets and investments from neighboring countries in the region, there is a need for policy and institutional reforms, improved governance, stronger social partnership and greater sense of concern for collective interest among workers, management and government drawing in part on Filipino cultural values, and forward looking leadership. Toward this end, the next sections present a framework for Philippine development drawing from the success stories of countries in East Asia and Germany.

Towards a Philippine-style social market economy

The experiences of Germany and the East Asian countries indicate that for development programs to be meaningful and empowering, they must be rooted in the peculiarities of a society's history and its own value systems. Germany's co-determination, Japan's system of *keiretsus* and lifetime employment, and Singapore's paternalistic state all emerged as a result of those countries' historical experiences. They were successful in their own time particularly because they were the products of a genuine social consensus that derived from the value systems of their respective societies. That is, all successful development programs—from the European to the East Asian—have been imbued with an unmistakable national and cultural character. This warns us that merely transplanting policies and social arrangements (such as wholesale adoption of the Washington consensus) is not likely to either answer the basic needs of the public or generate the kind of support needed to sustain the vision. On the other hand, it also indicates that a broad policy such as liberalization and economic openness can find expression in a number of different ways, and indeed, should be designed with the specific conditions of the Philippines in mind.

A social market economy is built by partnerships among the key sectors of society. But having said this, the aim of any social partnership ought to be more than just obtaining the highest productivity from Filipino labor. Indeed, at the heart of this social partnership must be an organizing principle for society: a principle that simultaneously captures national aspirations and at the same time springs from indigenous values.

While this point may seem obvious, we would argue that a number of our past development programs have been found wanting in this respect. Rather than acknowledging that Filipino culture and value systems can be a valid factor for development, they tend to define their objectives with scant regard for a social consensus (say, on the pace and scope of liberalization). The effect is to end up prescribing fundamental changes in behavior as a pre-condition

to development. Needless to say, such an approach is unlikely to gain widespread acceptance and is ultimately disempowering.

We argue then that development strategies must be animated by indigenous cultural values. We see values not as mere luxuries to indulge in only after attaining a certain level of industrialization, nor empty exhortations that decorate government plans. They represent the collective wisdom of a society and its means of resolving the dilemmas of development: how to increase productivity in a humane and fair way, how to strike a balance between modernity and tradition, what role should government play in society? And although values are capable of change, they are said to be evolutionarily stable, and represent time-tested strategies for survival and maintaining a certain level of social stability. Values give development plans resonance and people a psychological incentive to participate.

In arguing for the need to have a culturally-defined social partnership, we do not mean to romanticize Filipino culture, nor claim that it is incapable of adaptation and change. Our contention is that, in seeking a way out of the dilemmas of development

facing us, we can use elements of our culture to determine what we as a nation value. In doing so, we would be better able to address the needs of Filipino society, and to define the parameters within which we interact with the outside world. We would be able to define and resolve the tradeoffs that accompany all attempts at development (equity and efficiency, competitiveness vs. protection for the vulnerable, short-term sacrifices vs. the promise of long-term recovery). This process would not just be in consonance with the experience of other social market economies. It would also create a powerful psychological incentive for the public to fully participate in its own development.

Pakikipagkapwa-tao as a core value of a modern RP development philosophy. According to Virgilio Enriquez, the "father of Filipino Psychology", no cultural value is more important to Filipino life than *pakikipagkapwa-tao*.

We must stress that this is **not** the same as the oft-cited "smooth interpersonal relations", which carries suggestions that, as nation, we will do almost anything to avoid confrontation with others – including turning a blind eye to wrong-doing. Neither is this the same as *pakikisama*, which has been blamed for all sorts of distortionary behavior, ranging from influence peddling and nepotism to shirking and mediocrity in the workplace.

Rather, *pakikipagkapwa-tao* is more accurately translated as a "shared inner self". It is a deep identification with others, resulting in a basic sensitivity that influences all aspects of our interaction. Indeed, it is often the basis for what Filipinos perceive to be decent conduct.

Pakikipagkapwa-tao is normative in that it prescribes behavior, and imbues relationships with a high degree of **unstated** obligation – i.e., the obligation to be *makatao*, no matter what one's station in life is. The implicit nature of this value means that *pakikipagkapwa-tao* operates not through set structures, but through **relationships**, many of which are informal. In small, relatively homogenous communities, this can form the basis of strong and lasting social bonds that lessen transactions costs. The challenge is to adopt them to modern society, in which people are more mobile (making it harder to form long-term relationships), and where transactions are increasingly impersonal.

Pakikipagkapwa-tao is not merely an affirmation of the common good or of the public's welfare. This is because *pakikipagkapwa-tao* is about processes just as much as it is about outcomes or objectives. For many Filipinos, it is not enough that leaders or managers seek to do something for the common good; the manner in which a policy is formulated, negotiated and carried out must likewise be *makatao*. Often, process questions and the conduct of the persons involved in a negotiation or working relationship are what determine the level of morale or dissatisfaction within the firm.

Above all, *pakikipagkapwa-tao*, although prescriptive, is not rigid. It is not a legal code and, in fact, eschews Western-style

legalism. Filipinos accept, for instance that there are many ways (both direct and subtle) of demonstrating that one is *makatao*. Likewise, *pakikipagkapwa-tao* does not insist upon a dissolution of hierarchies and power structures, and, in fact, can be the basis for satisfactory and fair relations even within the most hierarchical of establishments.

These attributes of our indigenous value system are extremely important because they provide a powerful store of flexibility and innovation needed to deal with a rapidly changing global environment.

The challenge, of course, is to harness the matrix of cultural values represented by *pakikipagkapwa-tao* in a way that meets our most pressing development needs and equips us to deal with the problems of a complex, modern, and increasingly open society. To prove its worth as the basis of a development philosophy, *pakikipagkapwa-tao* must do more than cause people to wax nostalgic: it must provide new insights and approaches to dealing with our long-standing problems.

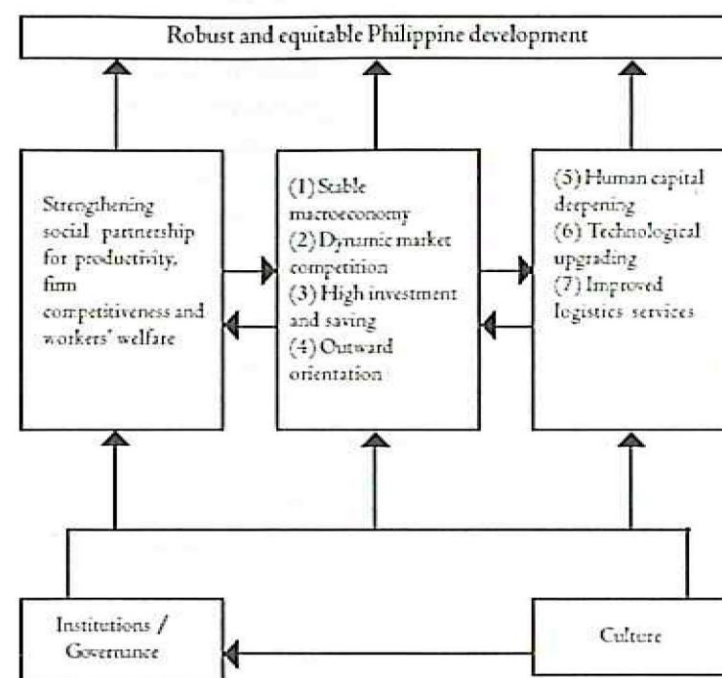
We propose in the next section that we harness the value of *pakikipagkapwa-tao* as a glue that can foster stronger social partnerships among workers, management and the government. In addition, *pakikipagkapwa-tao* is an important value for improved governance (i.e., corruption is a negation of *pakikipagkapwa-tao*) and citizenship, for an essence of *pakikipagkapwa-tao* is the emphasis on the collective interest over the personal interest.

Features of an RP-style social market economy

We propose to address the four challenges faced by the country, using the framework of a Philippine-style social market economy. This development framework has the following features: (1) macroeconomic stability based on fiscal discipline and strategic investment, both of which are shaped by a clear consensus on government's, businesses' and labor's roles in development; (2) competitiveness based on industries that tap national reserves of human and cultural capital; (3) improved governance and leadership

based on a true social contract; and (4) social partnership achieved through norms and institutions consistent with Filipino values.

Figure 1. A Framework for Philippine Development



To achieve macroeconomic stability, it is extremely important for the government to reign in its fiscal deficits and reduce its debt overhang in order for it to facilitate a smoother recovery of the domestic investment rate, prevent unnecessary spikes in the domestic interest rate and inflation rate, and engender a more robust economic growth. Regaining fiscal discipline and credibility has become the most urgent economic issue for the country. Reigning in the fiscal deficits means increasing the tax and revenue effort as a ratio of GNP, and tempering the growth of government expenditures.

Proposals to improve the tax effort revolve around widening the tax base, increasing the tax take from the same tax base, reducing tax evasion and improving tax administration. They include the following: (a) indexation of taxes on "sin" products; (b) indexation of the VAT base; (c) imposition of/increase in tax on potentially high-yielding tax bases (petroleum, text messages, other imports); (d) greater use of expenditure tax especially for products that largely cater to the rich; (e) the use of presumptive taxation for difficult-to-tax taxpayers such as small businesses and professionals; (f) temporary freeze in the internal revenue allotment for LGUs; and (g) a host of specific proposals to improve tax administration, including a more effective and hands-off use of information in the system for tax and auditing purposes (e.g. computerization), tougher and swifter implementation of penalties on tax cheats, and the replacement of such graft-ridden government revenue-generation bureaucracies with more independent but accountable corporate semi-government institutions (e.g. NAIRA).

To improve the investment climate, gain investor confidence, and ultimately generate much higher investments in the country, a wide range of initiatives must be undertaken. These initiatives include reducing political uncertainty, preserving peace and order, and avoiding policy inconsistency. Addressing the fiscal problem and maintaining fiscal discipline would also improve investors' expectations about the macroeconomy. The country must likewise be more aggressive in improving its infrastructure stock, which may well mean a higher share of the total government expenditures that goes to infrastructure investments. Given the tight fiscal situation of the government, however, it may well encourage the private sector to undertake more of the infrastructure investments. This calls for easing the foreign equity requirements on infrastructure projects (including logistics services like water and air transport) and depoliticization of the setting of public utility rates. Moreover, this requires reducing corruption and addressing governance problems that effectively increase the

cost of doing business in the country. Finally, it is important for the government to reduce regulatory obstacles to business growth such as in starting a business, registering property, etc. The Philippines does not rank well vis-à-vis competitor countries in the region in a number of its regulatory obstacles to business growth, based on the 2005 World Bank Report on Doing Business.

The substantially higher investment rate needs to be financed domestically as much as possible to make it sustainable. Despite the rise in the national saving rate in recent years, there is still a need to raise it further. An increase in the per capita income would contribute to that increase in the future. Similarly, an increase in the government saving rate consistent with the more prudent fiscal policy would also contribute to an improved domestic saving effort. Nonetheless, the experience of the high performing East Asian countries during the 1965-1995 period indicates another **important and powerful source of increased domestic saving and growth; that is, the secular reduction in the fertility rate and population growth rates of the countries** during the period. This is the so-called demographic bonus. The demographic transition had the effect of reducing the increasing the proportion of productive and well earning population to the non-earning and dependent population. This resulted in an additional growth kick (given the good investment fundamentals), increase in per capita income and further rise in saving rate. It also enabled households and the countries to invest more in the education and health of the children and thereby improve the human capital foundations of their long-term growth potentials. Some analysts have argued that up to perhaps one-third of the growth surge of the high performing East Asian economies during the period could be attributed to the demographic bonus.

Finally, the investment climate will also improve with peace and development in Mindanao. An unstable Mindanao raises political risk premium on Philippine debt and investment financials. In addition, Mindanao offers substantial opportunities, especially in agribusiness. It is best that the program of development for

Muslim Mindanao is drawn with strong participation of Muslim communities, consistent with the comparative advantage of Muslim Mindanao in the context of the whole country and BIMP-EAGA, and considers culture as a potential asset for development if well-tapped.

To promote outward orientation, which has been a key ingredient for economic success in many countries, it is important to improve the country's ability to compete internationally as economies become increasingly integrated. To improve the country's international competitiveness, attain high economic growth, and significantly reduce the country's high unemployment and underemployment rates, it is imperative to substantially raise labor productivity, temper the unit cost of labor, and promote technological and product upgrading.

Raising labor productivity requires an increase in the amount of capital per worker, not only in terms of machines and buildings, but also in terms of infrastructure and logistics services. Given the comparatively higher cost of unskilled labor in the country, the Philippines needs to improve the efficiency of other business-related costs, of which infrastructure and logistics services are particularly important.

Improving the country's infrastructure and logistics services necessitates the following: (1) competition among providers of logistics services; (2) liberalized foreign equity rules; and (3) creative use of official development assistance for long term financing infrastructure and trade facilitation investments. Also, considering that government infrastructure projects have been known to be riddled with corruption, a transparent and competitive bidding process as well as more rigorous and less corrupt implementation of public infrastructure projects would go a long way in improving public perception of the problem of corruption in the country.

Tempering the unit cost of labor, on the other hand, involves not only increasing labor productivity, but also keeping down the cost of living of workers, the rise of which forces them to ask for

higher wages. This means addressing "wage goods" such as the high cost of food, which can only be done by improving agricultural productivity. Consequently, this also increases the incomes of farmers and farm workers, which consequently deepens the domestic market. Hence, the importance of investing more in, and ensuring more effective administration of, agricultural research, development and extension as well as irrigation, the two critical channels of improving farm productivity in the country.

To further improve international competitiveness, the Philippine industrial sector can be said to have gone down the 'low road' in the 1990s. Except for certain industries such as electrical machinery, where productivity growth was reasonably high, many industries had at best marginal increase or even suffered decline in labor productivity during the decade. At the same time, the average labor compensation of firms employing 20 people or more declined significantly in real terms during the 1990s. This means that, in the face of increased foreign competition, many manufacturing firms in the country were primarily propped up by declining real labor compensation rather by rising labor productivity.

It is clear that the "low road" to industrial adjustment is not socially and economically sustainable in the long run. Increases in productivity are the only sustainable basis for raising wage rates. What is needed is firm-level investments in worker productivity in addition to industry-level and economy-wide adjustments and support structures like more efficient trade facilitation and logistics services and facilities. The experience of NICs indicates that in-house, firm-level, on-the-job training have a particularly large impact on the marginal labor productivity of an industry.

The incentive to train workers, however, is heavily dependent on a number of things:

- (a) the existence of a 'long-term' view among entrepreneurs;
- (b) an investment climate with acceptable levels of risk (to reduce the moral hazard problem inherent in training highly mobile workers); and

- (c) a sound policy framework that creates expectations of future macro stability

For Philippine industries to get on to the 'high road' to productivity improvement, they can harness the benefits of technology transfer available from participation in global production networks. In particular, industry studies of recent success stories have shown that buyers are a prime source of ideas for innovation and quality upgrading. However, the unsettled industrial relations climate of the Philippines especially during the latter 1980s has made it more difficult for such long-term regional client links to form.

Still, there is enough reason to be mildly optimistic about the prospect of industries being able to make the needed adjustments. In the case of the shoe industry, the failure of Marikina to move away from small-scale, supply-driven means of production has been compensated for by a more vibrant footwear industry in Cebu that has been built along more integrated lines. The fact that such adjustments can be made in the face of a hostile macro environment means that industries are likely to respond even more positively to improvements in governance and macro stability.

The country would need to move up the product and technology ladder in response to shifts in regional and global production networks. It would need to define and strengthen its niches in the industries where it is losing competitiveness (e.g. garments, footwear) by improving product quality, production timeliness and supply reliability, and product innovation. At the same time, more pro-active and better-funded investment promotion and facilitation areas where the country has current and emerging comparative advantage is warranted. Investments of the private sector and possibly common service facilities are important to facilitate upgrading by firms and industries. In addition, because most of the private firms affected by international competition are small enterprises, special credit programs like leasing programs

for SMEs would be needed to help firms undertake the needed technological upgrading.

Upgrading and innovation necessitates a deepening of human capital. Thus, the country has no choice but to invest continuously in improving the skill level of Filipino workers as part of the country's industrial adjustment process. Unfortunately, there has been very little investment in the training of workers in a number of beleaguered industries such as garments, footwear and textiles. Training of workers is an important means of reducing the productivity gap vis-à-vis more efficient domestic and international firms. In addition, we must raise the country's expenditures to improve the quality of basic education and access of the poor to quality basic education. We need to reorganize the country's science and technology sector to make it more responsive to the needs of industry and at the same time make it more focused on selected areas and industries of substantial significance to the Philippine economy. Finally, it is critical to increase the stock of high-level scientists, engineers and researchers especially in selected high priority science and technology areas to improve the country's adaptive capability.

To improve governance and leadership, the recent high profile corruption scandals highlight the importance of putting ethics and anti-corruption high up in the policy agenda. The issue of corruption is particularly salient because the government agencies in charge of areas where the country is especially wanting relative to comparator East Asian countries are known to have high incidence of corruption *ie* internal revenue, customs, infrastructure and defense/peace & order. To strengthen anti-corruption, suggestions include increasing substantially the number of investigators and lawyers under the Ombudsman, raising penalties, and strengthening the protection of whistleblowers and witnesses.

The fight against corruption in the Philippines undoubtedly suffers from a lack of capacity – not an absence of laws. Studies

show, in fact, that the Philippines has some of the most comprehensive anti-graft laws in Asia. The enforcement problem is due, in large part, to a lack of government resources set aside for anti-corruption drives. To get a sense of the gap, one only need compare the resources devoted to fighting graft in, say, Hong Kong.

Hong Kong, a country that only 25 years ago was ranked among the most corrupt in Asia, now invests per person on anti-corruption measures that is about 140 times more than what the RP Ombudsman spends per capita. In addition, there are 1,226 'bureaucratic personnel' for every 1 staff member of the Ombudsman – which should say something about the magnitude of the oversight needed. In contrast, Hong Kong has 1 anti-graft personnel for only 131 bureaucrats.

This lack of capacity also affects the judicial disposition of cases. A lack of investigators makes it more difficult for the government to obtain evidence needed to successfully prosecute grafters. Well-trained lawyers and staff are needed, and existing technologies (web-based complaint centers, toll-free numbers for informants, a 'Whistleblower's Protection Act') must be harnessed in order to lead the fight against corruption.

The following long-standing recommendations to strengthen institutions must also be given due attention: (1) To stabilize the business environment and to ensure a predictable climate for investment and long-term planning, discourage the widespread use of TROs and judicial interference in business decisions, unless the situation meets a rational and well-defined set of criteria for intervention; (2) Restructure the incentives facing the judiciary in order to increase the efficiency with which cases are settled and to reduce moral hazard problems; (3) To strengthen the party system, consider the possibility of campaign finance reform via mandatory and audited declarations of received contributions so as to place a cap on total campaign spending, and so as to give "marginal" but deserving candidates a more level playing field; (4) To professionalize the bureaucracy, limit the number of political appointments (at the moment, they reach all the way down to the level of division

chiefs, twice the number compared to other East Asian bureaucracies). Needless to say, this must be replaced by a promotion system that is generally merit-based and which matches private sector incentives.

To strengthen social partnership, we need to harness the possibilities of the cultural value of *pakikipagkapwa-tao*. The challenge is to encourage a kind of social partnership whose objectives and institutions are resonant within Filipino society.

As such, we suggest a formula whose components are the following:

- firm-level social contracts and labor arrangements that are flexible but negotiated;
- which are based on trust and good relations;
- and which the state helps to guarantee.

The point is that in order to achieve a partnership that is *makatao*, workers should not be presented with what amounts to a take-it-or-leave-it proposition. Such an approach would be unsustainable and would generate a climate of distrust from which everyone loses. Instead, the dignity of labor should be affirmed by efforts to ease the burden of adjustment for workers, and making them share in any efficiency gains.

In particular, the conduct of labor-management negotiations must be guarded carefully, especially since the exigencies of the global business climate can always be used against an already vulnerable labor force. An outcome in which labor continually accedes to management demands because the only other option is unemployment, does not qualify as genuine development, nor does it build social capital. Thus, the lifestyles of top executives and supervisors, how they exercise managerial discretion in difficult times, and how they negotiate must be consistent with a value system that upholds *pakikipagkapwa-tao* in order to build the trust that is critical in collective bargaining. Hierarchical labor-management relations may still be acceptable, and co-determination

or continental-style labor parties may not be necessary if the social partners perceive their humanity and dignity to be sufficiently acknowledged.

Efforts must be undertaken to establish certain norms that are acceptable to both management and labor. These norms are superior to laws in that their flexibility allows them to deal with contingencies that rules, laws, and standards may not foresee. Without ignoring labor laws (which are, after all, an integral part of the social contract), these norms could serve to speed up the collective bargaining process.

For this to take place, however, there must be high levels of trust (or what the World Bank refers to as "social capital") shared among the partners. A key element of this trust-building process is *pagiging makatao*. This means **implicit but reciprocal obligations**: a sort of *noblesse oblige* on the part of employers in exchange for solidarity from workers. For example, in exchange for emerging and perhaps necessary labor practices such as labor-only contracting or piecemeal work, workers should receive reciprocal benefits (e.g. firm-level training to aid adjustment to new conditions, as well as a wage structure that is tied to productivity gains). The point is to achieve a partnership that recognizes the dignity of labor.

To be sure, the principle of investing in workers to obtain greater productivity and a better workplace atmosphere is already being embraced by a number of successful family firms and large corporations. Still, the spread of this norm must be accelerated. The process of generating norms and signaling good behavior can be done through periodic dialogue within the business community, in chambers of commerce, in universities that offer business courses, and especially in informal organizations such as those that exist among Filipino-Chinese clans. The role of influential business leaders and public officials here is critical, as this involves the difficult process of norm creation. If business leaders that are *makatao* do not do their part in enjoining others to follow, norm observance is not likely to be pervasive.

In the end, of course, the state has a role to play as a guarantor of public norms and as a prescriber of socially acceptable values. This means that informal efforts at spreading good behavior must be supported by key institutional reforms and policy initiatives. Among the reforms that could possibly be undertaken are as follows:

- (1) Policies and programs designed, foremostly, to reduce the cost of wage goods (housing, transport, food). In order to create an industrial relations atmosphere that is conducive to stable wages and increased productivity, it is imperative that the problem of high-cost wage goods be addressed.
- (2) Creation of incentive packages for firms that adopt best-practices consistent with a *pakikipagkapwa-tao* ethic; the monitoring and validation for this could involve the active participation of appropriate civil society organizations;
- (3) Matching programs in which firm-provided investment in workers is matched by a government contribution. This is useful in that it helps correct the under-investment in worker training that arises from fears that workers will leave before the firm can recoup costs. Counterpart government funding would address this and increase the overall investment in worker training;
- (4) Support for universities and institutions that generate a research program on new paradigms of industrial relations: this includes documenting successful cases, generating new models of collective bargaining and litigation, designing courses that incorporate the teaching of desirable norms, instituting practicum programs and industry tie-ups that allow students to learn these norms first-hand, etc.
- (5) Support for the establishment of a certification system, not unlike the ISO model, but which is based on an index of intra-firm relations.

- (6) Affirmation of a *pakikipagkapwa-tao* approach in political statements, judicial decisions, and media advocacy.

The trust that smoothenes industrial relations and strengthens social partnership is not generated spontaneously. Rather, it requires an environment conducive to its development – particularly, one in which there is transparency and accountability among partners. While transparency and accountability are key elements in good governance, they also serve to affirm the equality of social partners; thus, a commitment to transparency in dealings is consistent with the ethic of *pakikipagkapwa-tao*.

The underlying principle in all of this is that the public has an interest in the conduct of industrial relations and that the actions of private firms and unions should be consistent with social objectives. Clearly, this implies significant reforms in the governance of both firms and labor organizations, as all too often, these institutions operate with very low levels of transparency.

Legislation that defines standards of transparency would go a long way toward correcting these distortions and providing all social partners with the kind of information needed to make negotiations meaningful. Again, this implies both corporate and union reform.

- (1) **Corporate reform.** This may involve legislation that requires full disclosure of the true financial state of the corporation. Such reforms would be especially relevant given the spate of recent international corporate scandals; government may wish to consider a number of models and indicator systems that have been developed in other countries as a response to this.

Also, corporate reform may involve a re-definition of the areas covered by “management prerogative”. Expectedly, the government will encounter much resistance in this endeavor, but there are clear benefits to standing firm. Key

decisions on downsizing, compensation, promotion, when defended on these terms, generate resentment and disaffection and undermine the legitimacy of the collective bargaining process. When taken to the extreme, even the most unjust of measures can be rationalized in terms of “management prerogatives”. Re-formulating this concept in collective bargaining and setting clear limits on its application would affirm the public interest in the humane conduct of all negotiations.

- (2) **Union reform.** Like many other civil society organizations, unions suffer from problems of bad governance as well. In particular, reforms are needed in the area of financial transparency, leadership selection, and member participation in board-level decisions. Most of all, the relationship between union leaders and their management counterparts is fraught with moral hazard problems. Secrecy and the lack of transparency make it possible for deals to be made that reward the union’s leadership more than its members. In keeping with the nature of the bargain, unions must themselves undertake reforms to ensure transparency and good governance. These would involve many of the same measures that corporations would be subjected to: external audits, mandated provision of information to stakeholders, enlistment of appropriate watchdog organizations in the conduct of elections, periodic net worth checks on leaders, and others.

At the moment, many successful firms in the country already employ elements of *pakikipagkapwa-tao* in their dealings with workers. What are needed are incentives, institutions, initiatives, and continuous advocacy to spread the practice of this norm.

Toward a Filipino social contract

In keeping with the principle that development strategies work only when they are consistent with a nation's culture, we envision an RP-style social contract that draws heavily from the most basic of Filipino institutions: the **extended family system**. This implies an arrangement along the following lines:

- (1) The role of government, as in extended families, is firstly to secure minimum basic needs – defined according to the family's (and therefore in this case, the nation's) economic capacity. In particular, the typical extended Filipino family tends to provide support for the housing, food, and medical needs of the next generation. This does not necessarily imply a European-style welfare system, but instead provides the state a framework for prioritizing its resources for social services in a way that is demand-driven and reflective of community preferences and traditional values, rather than top-down and artificial.
- (2) But more than this, the metaphor of an extended family implies a set of social norms and acceptable behaviors that define the lengths to which a government must go to secure such needs. Filipino household heads are expected to think creatively, live frugally, spend wisely, and bargain assiduously on behalf of family members. Such values and expectations can form the basis for a code of ethics for public service.
- (3) Thirdly, it is to provide a reliable social safety net to shield against vulnerability. Extended families have historically carried out this role by providing opportunities – particularly in education and employment, rather than giving doleouts or entitlements. In the context of an RP-style social contract, this could take the form of public investments in education (oriented toward primary and secondary levels, since the social externalities are strongest

here) and support for the search costs of employment (by setting up job information centers for better matching, for instance). Such programs would address the primary concerns of Filipino families while being non-distortionary.

- (4) Finally, the state is to serve as a source of norms and a preserver of relations, in much the same way as do patriarchs/matriarchs of extended families. Such a contract would be consistent with a number of aspects of proposed constitutional changes – for instance, one in which a president has limited powers as a symbolic head of state (and is consequently “above” politics), with a prime minister taking care of the day-to-day business of government. The chief function of the president in such a set-up would be to generate signals and serve as a mediator and unifier in areas of deep political division.

There is, of course, the valid concern that constructing a social contract around the extended family system would make Filipino society even more dysfunctional. Sociologists have argued that the inability of Filipino families to look beyond their parochial interests toward the common good is a leading reason for the failure of governance reform in this country. Furthermore, the concept smacks of a pre-modern nostalgia that calls for small, tightly-knit groups as a basis of social organization. This metaphor of government-as-extended-family may be ill-suited to the needs of a modernizing society, where many commercial and political relationships can be undermined by excessive reliance on familial ties.

We affirm the validity of such concerns, but it is **not** our intention to pattern Philippine society after the family structure in a wholesale fashion. Instead, we mine the extended family system for clues as to the priorities, preferences, and expectations of Filipinos. Our view is that this version of the social contract would refine the concept of citizenship by providing not just an inventory of rights and responsibilities or positing Filipinos as claim-holders

and duty-bearers, but by rendering explicit those roles, norms, and expectations that have long been a feature of Filipino family life. In doing so, it would affirm Filipino value systems and social arrangements, preserving them as part of our heritage and identity, while giving the notion of citizenship more resonance among the public.

The question of leadership

It is apparent that strengthening social partnership, improving the investment climate, facilitating smoother economic adjustment, engendering a competitive but fair marketplace and ensuring a stable macroeconomy in the country demands the highest sense of leadership, effective & fair governance, institutions, and widespread support and cooperation from the populace.

There is a general consensus on what our social institutions should be: efficient, accountable, transparent, and participative. There also seems to be a good sense of the more obvious limitations of our institutions. Weak enforcement and the lack of political will are the most frequently cited. The phrase "strong demands, weak institutions" accurately captures the challenge of governance reform we face as a developing society.

In discussions of institutional reform, it is useful to separate out the elements of the problem. "Poor enforcement" and "lack of political will" are derivative phenomenon and are due to different factors. Lumping them together is not likely to be helpful as doing so merely gives one a sense of helplessness and overwhelming paralysis.

In our view, the lack of enforcement, lip service, or *pagkawatak-watak* can often be traced to the following elements:

- (1) **Regulatory "capture" and regulatory "chill"** by elements of the elite (local and foreign) and other vested interests – that results in pro-poor rhetoric but pro-rich legislation, for instance. The classic examples of this include our experience with urban land reform, the privatization of key GOCCs, and the design of safety nets for industry liberalization.
- (2) **Lack of a legal mandate to plan for the long-term and enforce.** The problems of higher education reform are instructive. At present, CHED has no mandate to plan educational outcomes (e.g. number of graduates in key areas,

dispersion of SUCs, etc) despite the glaring need for an overall direction for education policy. Instead, important decisions such as the creation and maintenance of state colleges and universities are left in congressional hands, which often results in regulatory capture. In such a case, what is needed is not blunt "political will", but a legal mandate that would allow higher education officials to rationalize educational outcomes.

- (3) **Existence of a mandate, but lack of budgetary and logistical capacity.** The most obvious example of this is in law enforcement, where the resolve to fight criminality is often not matched by equivalent resources. The same is true for environmental regulations: each year, more and more environmental legislation is mandated, but rarely with appropriate increases in the resources available to government agencies for enforcement. The result, of course, is toothless laws and disdain for the legal authority.
- (4) **Tolerance of public servants with a record for corruption and inefficiency,** which creates cynicism and saps public faith in institutions. This point is almost self-evident, if we are to go by the number of politicians and civil servants who have succeeded in re-making themselves and resurrecting their political careers. Closely linked to this is the belief that there are no alternatives to existing public figures, or no alternatives to the sort of politics currently practiced.

Good leadership, that elusive quality we seek in our leaders, requires an understanding of the different strategies for each aspect of the enforcement problem. For instance:

- (1) Sometimes good leadership calls for more enlightened legislation rather than brute "enforcement" – in particular,

simplifying investment and income tax laws, rationalizing mandates of overlapping government agencies, decentralizing authority in order to guarantee that target groups are empowered, and developing clear performance standards and reward structures.

- (2) Other times, it requires focusing on a few "big fish" issues, which generate powerful signals and satisfy pent-up demands for social justice, thus generating goodwill and confidence. These are probably where the traditional attributes of "political will" are necessary. Having said this, good leadership requires strategic selection of such cases in order to avoid the sort of attrition or protracted involvement that eventually backfires.
- (3) Still other times, it requires the judicious use of institutional "lock-in" mechanisms, which help minimize the chances of the reform process being hijacked or retarded. A good example of this is the use of membership and participation in international organizations. Our ratification of the WTO charter, it can be argued, has saved presidents from the politically difficult job of liberalizing protected sectors one by one. The treaty, instead, allows lock-in and minimizes the chance of the liberalization process being hijacked by vested interests, as in the past. The same mechanisms may be employed for policies that are painful but necessary: logging and fishing quotas, family planning and population control, even ceilings on government debt.
- (4) Good leadership may also take the form of enlisting of civil society "enablers" and "watchdogs" to safeguard key processes in the delivery of important services. This is consistent with the principles of subsidiarity and decentralization. Subsidiarity requires that problems be addressed at the appropriate levels of government, being

brought to the national leadership only when there are jurisdictional problems or spillovers. In this sense, leadership means willingness to rely on agencies and parties who may be closer to the situation. It also means allowing target groups to define programs according to their own needs, and intervening only when distortions are produced.

- (5) Finally, good leadership requires a willingness to participate in painstaking negotiation, representation, and a personal desire to communicate, especially when such issues involve painful adjustment on the part of the vulnerable. This is probably the sense in which personal charisma does and should matter in elections. Public officials, after all, should not confuse a definite and well thought-out agenda with the license to railroad reforms.

In sum, what kind of leadership does our political system and emerging nation require? Certainly not a blunt, uni-dimensional brand of leadership, but one that is characterized by the sort of acumen that allows one to harness the power of legislation, international influence, lock-in mechanisms, the energy of civil society, and even one's personal charisma to achieve on-the-ground results.

A Reform Agenda

Hereunder, we present a summary of the major points raised earlier. We also present an outline of a reform agenda consistent with the construction of a Philippine-style social market economy.

The basic question posed is:

How did a country with comparatively educated and creative people, and with good natural resources, end up being a growth laggard, poor, and with high unemployment?

To which we present two hypotheses:

- (a) Our institutions do not square well with the requirements of a changing global economy,
- (b) Our development strategy is not based on a social contract that is consistent with our cultural value system

We argue that the evidence from countries like Germany and the NIEs show that development comes as a result of some shared characteristics, such as macroeconomic stability, policies that promote equity, and foundational good governance. These are the common features of what is often called a social market economy.

However, we also stress that each of these countries shaped their institutions and social arrangements according to their unique cultural values. There is, we argue, no "template" for development. Each country must construct its social bargain based on its own historical experience, conditions, and value systems.

A Philippine-style social market economy must be able to address the following dilemmas of 21st century development:

- (1) How do we increase productivity and competitiveness without feeding a social volcano? In other words, how do we make sure that our efforts at improving national efficiency do not come at a very high social cost?

- (2) How do we extend social protection to the most vulnerable sectors without ossifying markets or bankrupting the state? How do we design safety nets so that they do not distort economic incentives or worsen the country's fiscal deficit?
- (3) How can we maximize the benefits of an open global economy without undermining our traditional values and social arrangements? How do we adjust to a rapidly changing world while preserving our "social capital"?
- (4) What roles should we assign to government, business, labor and civil society so that we move with more cohesion? How do we undo the bureaucratic and legislative knots that prevent needed reforms from taking place more quickly?
- (5) How do we design our institutions and laws so that corruption is minimized? How do we send out strong signals of our resolve against corruption and put to rest long-standing cases in ways that satisfy the public's need for justice?

Proposed features of an RP-style social market economy

- (1) Macroeconomic stability based on fiscal discipline and strategic investment, both of which are shaped by a clear consensus on government's, businesses' and labor's roles in development;
- (2) Competitiveness based on industries that tap national reserves of human and cultural capital;
- (3) Improved governance and leadership based on a true social contract;
- (4) Social partnership achieved through norms and institutions consistent with Filipino values.

For macroeconomic stability

Address Emerging Fiscal Crisis.

- Clear policy statement to be fiscally conservative; i.e., fiscal deficit needs to be cut drastically. This is to gain confidence

and manage expectations of investors and reduce the risk premium on debt

- Raise tax effort (e.g. from sin taxes, oil taxes, value added and excise taxes), and improve tax administration
- Improve tax effort from income tax through e.g., "net worth checks" or lifestyle check
- Review fiscal incentives (tighter criteria, fewer sectors)

For increased productivity and competitiveness

(1) Strengthen agricultural research, development and extension system and the industrial extension system

- Need for clear industrial adjustment facilitation program by industry (with industry participation and financial co-funding)
- Restructure R&D system i.e., corporate and less bureaucratic, greater financial and operational flexibility, greater client orientation, stronger links with producers and private sector
- Industry financing with government counterpart funds in selected industries (e.g., research CESS, similar to Australia, Malaysia, and many other LDCs)

(2) Focus on infrastructure and trade facilitation

- Rethink ODA to introduce possibility of using it to generate for the Philippines long-term loans for infrastructure
- Encourage private investments; ease up on foreign equity restrictions
- More transparent government procurement and investment programming rules
- Regulatory reform in public utilities including energy
- Reduce regulatory obstacles to and streamline procedures for business growth.

(3) Deepen the human capital and technological foundations of sustainable long term growth

- Raise country's expenditures to improve quality of basic education and access of the poor to quality basic education
- Seek active participation of the various sectors of the society, including the Church, in order to have an effective national effort on planned and responsible parenthood and family planning.
- Reorganize the country's science and technology sector to make it more responsive to the needs of industry and farmers while at the same time make it more focused on selected areas and industries of substantial significance on the Philippine economy now and in the near future.
- Increase the stock of high-level scientists and researchers especially in selected high priority science and technology areas.

For stronger social partnership

A social contract based on the following principles:

- (1) The role of the state is to secure minimum basic needs – housing, food, and medical needs – as care and investment for the next generation.
- (2) Those in public service ought to adopt a code of ethics based on living simply, spending wisely, and thinking long-term.
- (3) Safety nets are to take the form of opportunities rather than dole-outs, except in the most extreme cases of need.
- (4) The state is to serve as a source of norms and as a unifier in areas of deep political division.

For improved and productive industrial relations

- (1) Firm-level social contracts and labor arrangements that are flexible but negotiated and provide for investment in labor;
- (2) which are based on trust and good relations;
- (3) and which the state helps to guarantee.

For peace and development

Pursue more vigorously peace and development efforts in Muslim Mindanao, with strong participation of the Muslim population, consistent with the comparative advantage of the region vis-à-vis the country and BIMP_EAGA, and which considers culture as a factor for development.

For political/institutional reform and better governance

- (1) Discouraging the widespread use of TROs and judicial interference in business decisions, unless the situation meets a rational and well-defined set of criteria for intervention.
- (2) Restructuring the incentives facing the judiciary in order to increase the efficiency with which case are settled and to reduce moral hazard problems.
- (3) Reforming campaign finance via mandatory and audited declarations of received contributions, to strengthen the party system and make it more ideology/platform-based.
- (4) Limiting the number of political appointments to professionalize the bureaucracy
- (5) Strengthen anti-corruption institutions and rules.

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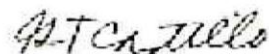
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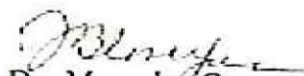
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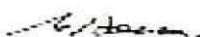
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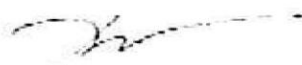
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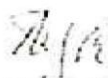
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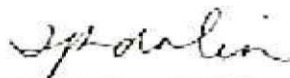
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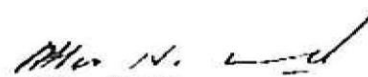
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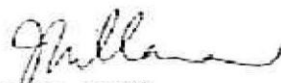
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This paper represents a modest attempt to address

The 'Philippine puzzle':

How can a country with comparatively **educated, creative** people, and natural **resources** end up being **poor**, a growth **laggard**, with a worsening social **situation**?

Four familiar **challenges**,
amidst **limited** options

1

Declining productivity & competitiveness

Decades of **under**-investment in agricultural **R&D** have created **large** productivity **gaps** vis-à-vis our neighbours. This productivity gap has created **pressure** for agricultural **protection** – resulting in higher food **prices** & wage **demands** – making labour **un**-competitive

2

Fragile macroeconomy

There is an emerging **fiscal** crisis, which creates **vicious** cycles and makes it very difficult to **fund** needed policy **reforms**. This implies that we **cannot** use **expansionary** fiscal policies, as in the past, but must rely on **progressive** taxation, and **credible** signals that encourage greater **investment** flows

3

Worsening income inequality & frayed social fabric

Both **absolute** poverty (number of poor families) and **relative** poverty (share of national income going to elite) **increasing**. This implies that a circa-**1990s** strategy of comprehensive **liberalisation** may just **backfire** & ignite the 'social volcano'

4

Weak institutions, strong demands

Endemic **corruption** saps resources & **goodwill**, erodes social **capital**, and creates discontent, apathy & **cynicism**. This implies a need to **attack** corruption by **reforming** institutions, **creating** incentives & **disincentives**, and **resurrecting** key **norms** & values

Lessons from recent 'success stories'

The 'success **stories**' tell us:

A country's social **objectives**, political **institutions** & economic **strategies** must be **consistent** with each other. This '**fit**' is **sustained** by a social **consensus** that is **not** borrowed or transplanted, but **designed** to match **unique** national & cultural **values**

Examples of this abound

Japan's **keiretsu** system, Germany's **social** market economy, Singapore's '**paternalistic**' state, and Malaysia's **bhumiputra** policy are all examples of a **unique** social-political-economic **nexus**

Now each of these **models** has definite **weaknesses** – but they are **accepted** as part of a **genuine** social **bargain**. This is why they **cannot** simply be **transplanted**

As a nation-in-progress, we have neither arrived at a social **consensus**, nor designed **institutions** to fit our needs

In short, we do not really have an **indigenous** development model to speak of – and we need one **urgently**

Reasonable expectations:

Our under-development is the result of **decades** of **neglect**, **misjudgment**, & **rapacity** – and **cannot** simply be undone in a few **years**, by a magic **slogan**, or even the 'right' **leader**. This is a **generational** project

However, we **can** break these vicious cycles & **unlock** virtuous ones by a measure of **leadership**

'Leadership' & 'political will'

The **will** to **re-design** institutions – ie generate **consensus** on priorities, **rationalise** mandates, **re-align** budgets, & **devolve** power to **communities**

Leadership in the **creation** or resurrection of **norms** through constant **signaling** – **punishment** of 'big fish', **simple** living, unimpeachable **conduct**

Toward an **RP-style social market economy model**

First principles

We must **acknowledge** that Filipino **culture & values** – our **peculiar** priorities, expectations, and **preferences** as a people – are a **valid** basis for development
Our unique **value** system should, in fact, guide us in **resolving** the **dilemmas** of development and **re-designing** institutions

These are **not** idle **statements**

Examples of **dissonance** among values, policies, & institutions are **everywhere**

we value **flexibility**, improvisation, 'tamang pagtimpla' – yet our government **structure** is patently **inflexible** & excessively **centralised** we value 'pagiging makatao', regardless of one's station in life – yet routinely **tolerate** race-to-the-**bottom** labour practices on the pretext that we need to **compete** with countries like **China**

This implies going **beyond** the "Washington consensus" – or any other **transplanted** development model – and forming a social **consensus** based on what we Filipinos **value, expect, & uphold**

Exactly what are these 'Filipino values'

'Pakikipagkapwa-tao' as a paramount cultural value & source of social limits for acceptable behaviour

'Pakikipagkapwa-tao' as a **basis** for an **RP** development **model**

No cultural value is more important to Filipinos than '**pakikipagkapwa-tao**' (Enriquez, *et al*). It is often the **standard** for what we perceive as **decent** behavior

Pakikipagkapwa-tao imbues relationships with a high degree of **unstated** obligation – it is **prescriptive** but **not** legalistic

'Pakikipagkapwa-tao' may become the **basis** for a **genuine** social **consensus** that past development programmes may have **lacked**

As a cultural **value**, it certainly has significant **implications** for the conduct of industrial **relations**

The extended family system as an organising principle for government & basis for a RP-style social contract

The extended **family** system as an **organising** principle for government

Looking into Filipino social **relations** can also help us **re-orient** national institutions to be more **consistent** with our **expectations**

For instance, the Filipino extended **family** system can shed light on the **relationship citizens** wish to have with their **leaders**

Five features of an RP-style SME model

- Explicit emphasis on a social bargain or partnership among key sectors – built on macroeconomic stability & growth and forged by key institutional reforms
- Government secures minimum basic needs, invests in human & physical infrastructure, guarantees social partnership, and behaves as elders are expected to in an extended family in exchange for legitimacy, cooperation, self-sacrifice & better social relations
- Business adopts a less take-it-or-leave-it, more '**pakikipagkapwa-tao**' approach to industrial relations in exchange for government policies that lower business costs as well as programmes that provide greater trade facilitation services

- Labour acknowledges need for newer & more flexible working arrangements to ensure international competitiveness in exchange for better provision of important wage goods & greater investment in worker productivity
- Civil society serves as an enabler & good governance watchdog in exchange for recognition, and a greater voice in policy formulation

Moving forward: from framework to **policy**

Common **characteristics** of recent
economic success stories

macroeconomic **stability** & growth

economic **openness** & export orientation

social equality; principle of '**shared** growth'

foundational good **governance**

Moving forward:

foundations for macroeconomic **stability** & growth

- Address emerging **fiscal** crisis
- Strengthen **financial** sector
- High **investment** rate critical
- Raise domestic **saving** rate

Moving forward:

meeting **challenges** of economic **openness** for
employment & growth

Challenges

- Expensive **unskilled** labour but cheap **semi-skilled** labour
- Large productivity **gap** in agriculture
- Poor **infrastructure**
- High labour force **growth** rate

Key Strategies

- Address 'wage goods' especially food through large agri **productivity** growth
- Improve infrastructure and logistics services & other trade **facilitation** services
- Develop and strengthen domestic production **networks** & clusters
- **Human** capital & **skill** development
- Investment in product **development** & across-the-board **technological** upgrading

Moving forward:

strengthening social **partnership**

- Flexible but **negotiated** firm-level social contracts & labour **arrangements**
- Partnership based on **trust**, good relations & less **legalism** in bargaining
- Government serves as **guarantor** of industrial **relations** by introducing trust-building & **transparency** measures

Short-Term and Long-Term Reforms

- Government **programmes** to reduce cost of important **wage** goods (food, transport, housing)
- **Incentive** packages for management **practices** consistent with 'pakikipagkapwa-tao' ethic
- Government **matching** grants to **firm**-level investments in worker training & productivity
- **Affirmation** of new 'kapwa-tao' ethic in policy formulation, judicial decisions and media **advocacy**
- **Corporate** & union **governance** reforms

Moving forward:

institutional **reform** & good **governance**

- **Break** vicious cycle of '**booty** capitalism'
- Strengthen party **system** to become more programmatic; campaign **finance** reform
- De-politicise/**professionalise** bureaucracy
- Undertake efforts at **judicial** reform
- **Disestablish** media **monopolies** to restore public **trust** in media & ensure genuine **democratic** expression

The challenge of **leadership**

An **RP**-style model: some **tough** choices

If we accept that the extended **family** system provides **insight** into what citizens **expect** from their **government**

Then would we be willing to commit to **universal** provision of **basic** goods & **educational** opportunity as **paramount** budgetary **priorities**, financed by progressive **taxation**, **investment** & **credible** anti-**corruption** measures?

Furthermore, would we support the enactment of a **code** of ethics for **public** service that **requires** our leaders to **behave** as **elders** in an extended family: Thinking **creatively**, living **frugally**, spending **wisely**, and bargaining **assiduously** on our behalf

If we accept that the **structure** of government **matters**, and that at **present** it does **not** uphold the values of **flexibility** & **community**-based **political** power,

Then would we consider **re-designing** it, say, along **federal** & **parliamentary** lines?

If accept that **corruption** is not a cultural '**trait**' but is instead the product of poorly-designed **structures** & the lack of a social **bargain** that sustains good **norms**

Then would we be willing to re-**design** bureaucratic **structures** & incentives as well as send out clear **signals** of intent by dealing with long-standing '**big fish**' cases?

If we accept that in the **Filipino** value system, wealth is **not** a licence to do **whatever** one wants, and that even the **elite** have an **obligation** to be **makatao**

Then would we consider **corporate** reform, '**presumptive**' taxation, net worth **checks**, **competition** policy?

If we accept that pakikipagkapwa-tao requires **trust**-building, which in turn can only be **based on transparency**

Then would we consider endorsing **measures** for **true** corporate **disclosure**, and **limits** on 'management **prerogative**' in the **conduct** of industrial **negotiations**?

In sum,

We revisit The 'Philippine puzzle'

How can a country with comparatively **educated**, **creative** people, and natural **resources** end up being **poor**, a growth **laggard**, with a worsening social **situation**?

- Culture **matters** and is **not** incidental to development strategy
- Development **targets**, **priorities**, **institutions**, policies and social **arrangements** should be **consistent** with (**unique**) national & cultural **values**

Recent 'success stories' tell us that **development** comes through **unique** social/economic/political **arrangements** that are the product of a **genuine** and **indigenous** social **bargain**

Perhaps an **RP-style** social market economy can be the **basis** for a development **strategy** that **works**, is **sustainable**, and **empowers**

Marami pong **salamat**. **Mabuhay** ang Pilipinas!